

ORCA EXPLORATION GROUP INC.

ORC.B-TSX V: \$3.44 — **BUY**

TARGET PRICE: \$6.00; PROJECTED RETURN: 74%

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PRODUCTION CONTINUES TO GROW WITH THE MARKET

EVENT – FINANCIAL AND OPERATIONAL RESULTS

Production averaged 23.7 mmcf/d (3,950 boe/d) for 2008, which was inline with our estimate of 23.8 mmcf/d (3,967 boe/d). Cash flow of \$10.3 million (\$0.33/fd share) was slightly below our estimate of \$11.6 million (\$0.37/fd share). The company exited 2008 with no debt and positive working capital of \$11.4 million.

IMPACT – EXPANSION OF FACILITIES SHOULD RESULT IN MULTI-YEAR PRODUCTION GROWTH

During peak demand season, production from the Songo Songo field was constrained by the capacity of the processing plant. In Q4/08, the Songo Songo natural gas plant was re-rated from 70 mmcf/d to 90 mmcf/d and the company expects that the facilities will be re-rated later this year to 110 mmcf/d. With 110 mmcf/d of processing capacity, Orca expects to have ample capacity to meet natural gas demand until 2011/2012. Longer-term plans include the expansion of capacity to in excess of 200 mmcf/d, roughly equivalent to the current productive capacity of the Songo Songo field. Orca has the ability to add significant production additions without assuming drilling risk.

VALUATION – UNCHANGED

Based upon the valuation for the Songo Songo natural gas field and including Orca's positive working capital, we calculate a NAV of \$11.84/fd share (Figure 1). No value has been included for the 552 bcf Songo Songo West exploration prospect.

RECOMMENDATION – MAINTAIN BUY

We expect Orca's production to steadily increase for many years with the growth in demand from the industrial, power, and compressed natural gas sectors in Tanzania. However, due to the current world economic uncertainty, Orca will focus on cost reduction and capacity expansion and has postponed exploration drilling until at least 2011. We maintain our **BUY** recommendation on the B shares and our \$6.00 target price equivalent to a 0.5x multiple of our net asset value. Orca's management team has a history of discovering and developing attractive assets that are eventually sold for a premium price, and we believe that Orca offers exceptional longer-term upside.

VALUATION CATALYSTS – PRODUCTION GROWTH

In 2009, Orca expects that the Songo Songo natural gas facilities could be re-rated to 110 mmcf/d, which should eliminate infrastructure capacity constraints until at least 2011.

Financial Metrics (C\$)

Shares O/S (mm)*:	29.6	Mkt. Cap (\$ mm):	\$101.9
FD Shares (mm):	32.4	W.Capital (\$ mm)**:	\$11.4
Price:	\$3.44	Ent.Value (\$ mm):	\$90.4
52-Wk High:	\$9.33	52-Wk Low:	\$1.76

* 27.9 million Class B shares and 1.75 million Class A shares.

**Positive working capital as of December 31, 2008

FY December 31	2007A	2008A	2009E	2010E
Production				
Liquids (bbl/d)	-	-	-	-
Gas (mmcf/d)	21.2	23.7	30.0	47.0
Boe/d (6:1)	3,530	3,943	5,000	7,833
Financials				
Cash Flow (C\$ mm)	\$9.2	\$10.3	\$23.4	\$44.7
CFPS (FD)	\$0.31	\$0.33	\$0.75	\$1.44
EPS (FD)	\$0.06	\$ (0.31)	\$0.38	\$0.89
EV/DACF	13.6x	11.7x	5.8x	2.7x
D/CF	na	na	na	na
2009 Quarters				
	Q1E	Q2E	Q3E	Q4E
Liquids (bbl/d)	-	-	-	-
Gas (mmcf/d)	28.0	15.0	35.0	42.0
Boe/d (6:1)	4,667	2,500	5,833	7,000
CFPS (FD)	\$0.10	\$0.07	\$0.25	\$0.25

Target Valuation Parameter

0.5x Risked NAV/fd share



Courtesy of BigCharts.com

Key Risks

All of Orca's production is derived from the Songo Songo field. Any unforeseen disruptions to production could affect Orca's ability to meet our targets. h.

Corporate Profile

Orca Exploration Group Inc. (www.orcaexploration.com) is an international oil and gas exploration and production company that produces and markets natural gas in Tanzania.

Multiple Share Structure

Orca has a two-share structure: 1.75 million Class A shares are outstanding with 20 votes each, and 27.9 million Class B single-voting shares. The Non-Executive Chairman of Orca holds 99.5% of the Class A shares and 17.5% of the outstanding Class B shares.

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NET ASSET VALUE

	C\$/share	C\$/share
Reserves (December 31, 2007)		
Proven	303.5	\$8.71
Probable	48.2	\$1.38
Total	351.8	\$10.10
Positive Working Capital (September 30, 2008)	11.4	\$0.39
Net Asset Value (Basic)	363.2	\$10.48
Risked Possible Reserves (Songo Songo Field)	0.0	\$0.00
Risked Resource Value (Songo Songo West)	0.0	\$0.00
Dilution Increment	7.0	\$0.06
Risked Net Asset Value (FD)	370.2	\$11.84
Converted at US\$/C\$:	0.85	

Figure 1. Net Asset Value Estimate
Source. Company reports, Research Capital

LONG-TERM PRODUCTION GROWTH

Orca's Songo Songo field is capable of delivering 210 mmcf/d from six high deliverability wells. According to the PSA, natural gas is classified as either **Protected Gas** or **Additional Gas**. The Protected Gas (grey bar) is capped at a maximum of 45.1 mmcf/d and is used primarily as feedstock for the Ubungo power plant at Dar es Salaam. Orca receives no revenue for Protected Gas; however, the company has the right to market Additional Gas, which is production in excess of the Protected Gas requirements. Generally, protected gas utilization has been averaging 85% per year (38 mmcf/d.). Below is Orca's base-case production estimate which assumes capital spending is funded entirely with cash flow. Production, net of protected natural gas, is expected to grow from an average of 23.7 mmcf/d in 2008 to approximately 110 mmcf/d in 2015 (Figure 2).

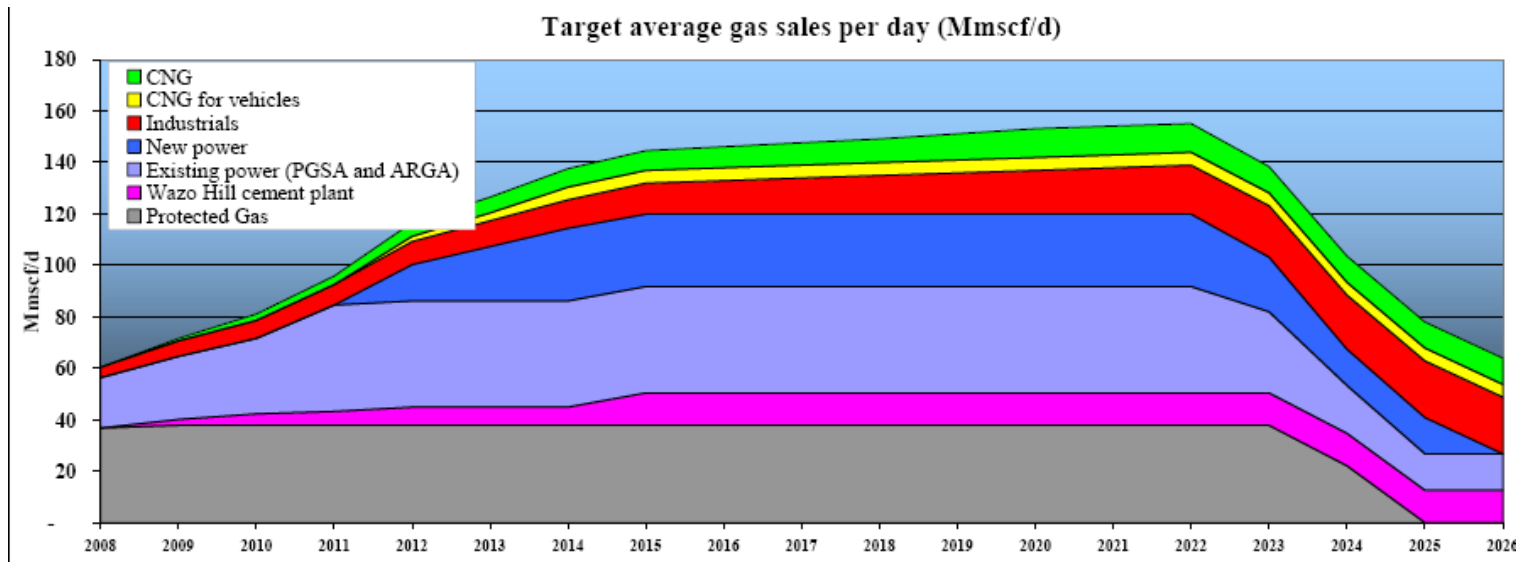


Figure 2. Base Case Production Forecast
Source. Company Presentation.

EXPANDING PROCESSING CAPACITY TO OVER 200 MMCF/D

The Songo Songo processing facilities are owed by Songo and are operated by Orca on a no-gain, no-loss basis. With the re-certification of the two existing dehydration and refrigeration trains, the Songo Songo facility is capable of processing 90 mmcf/d. Both trains were tested to 55 mmcf/d and the facilities may be re-rated to 110 mmcf/d with the successful inspection of the gas heat exchangers. Songas has submitted an application to the electricity regulator, EWURA, for the installation of a third and fourth gas processing train. Once installed, capacity could increase to 140 mmcf/d and after re-certification of the four trains plant could increase capacity to 220 mmcf/d (175 mmcf/d) net which is approximately equivalent to the field's current deliverability from the six production wells. With compression, Orca believes that capacity of the 230 km 16" pipeline to Dar es Salaam could increase to from 110 mmcf/d to 140 mmcf/d. The line would have to be looped to be able to process 220 mmcf/d.

GROWING INDUSTRIAL AND POWER MARKET

During 2008, Orca expanded its natural gas distribution pipelines by 7 kilometres to 42 kilometres. The line supplies natural gas to power stations and 20 industrial customers in Dar es Salaam. There is now surplus capacity that can

accommodate new customers. In 2008, Orca increase natural gas production by 12% to 23.7 mmcf/d. With demand growth in both the power and industrial sectors and the initiation of compressed natural gas sales, we expect production to average 30.0 mmcf/ in 2009 (Figure 2).

During 2008, Orca supplied an average of 19.6 mmcf/d to the power sector at an average price of US\$2.37/mcf, and 4.0 mmcf/d at an average price of US\$11.98/mcf to industrial users.

Average Additional Gas Production

		2004A*	2005A	2006A	2007A	2008A	2009E	2010E
Additional Gas								
Industrial	mmcf/d	1.0	2.1	4.0	4.1	4.0	6.5	9.0
Power	mmcf/d	0.0	4.6	9.2	17.1	19.6	23.0	35.0
Compressed Natural Gas	mmcf/d	0.0	0.0	0.0	0.0	0.0	0.5	3.0
Total Gas	mmcf/d	1.0	6.7	13.3	21.2	23.7	30.0	47.0
% Industrial Production			32%	30%	19%	17%	22%	19%
Oil Equivalent	boe/d	165	1,118	2,209	3,530	3,943	5,000	7,833
Y/Y Growth			578.6%	97.6%	59.8%	11.7%	26.8%	56.7%
Protected Gas								
Protected Gas Sales**	mmcf/d	3.8	32.5	35.6	31.7	33.8	33.8	33.8
Total Field Production	mmcf/d	4.8	39.2	48.9	52.9	57.5	63.8	80.8

Average Natural Gas Price

		2004A*	2005A	2006A	2007A	2008A	2009E	2010E
Industrial	US\$/mcf	\$5.31	\$7.07	\$8.22	\$9.31	\$11.98	\$8.50	\$8.50
Power	US\$/mcf	\$0.00	\$1.66	\$1.90	\$2.19	\$2.37	\$2.49	\$2.61
Volume Weighted Price	US\$/mcf	\$5.31	\$3.38	\$3.82	\$3.58	\$4.01	\$3.75	\$3.57

Figure 3. Natural Gas Sales

Source. Company reports, Research Capital

SSW EXPLORATION PROSPECT HOLDS SIMILAR POTENTIAL TO THE SONGO SONGO FIELD

Independent engineering firm McDaniel & Associates Consultants Ltd. (McDaniel) completed a reserves estimate of the Songo Songo natural gas field in Tanzania. At December 31, 2007, total net proven and probable (2P) reserves were estimated to be 474 bcf with an after-tax NP10 value of \$254.9 million. McDaniel also completed a resource estimate of the SSW exploration prospect, which is located approximately 2.5 kilometres west of the producing Songo Songo field (Figure 1). The SSW prospect has a similar geological structure to the Songo Songo field and is expected to trap natural gas in the same reservoir. McDaniel's unrisked recoverable resource estimate of 551.6 bcf is similar to the 2P reserves of the Songo Songo field (Figure 4). McDaniel assigned a relatively high chance of success to the exploration prospect of 50%. Valuing the prospect at \$0.25/mcf, we calculate a risked potential value of \$70.2 million (\$2.37/share).

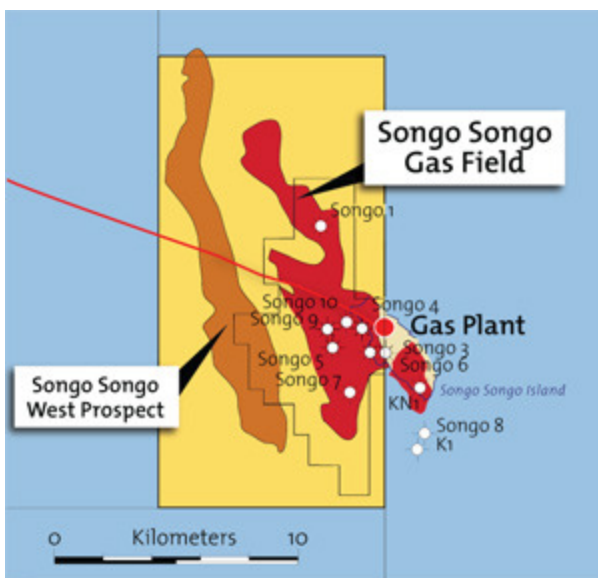


Figure 4. Songo Songo Field

Source. Company reports



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